

**STATE OF WASHINGTON
OFFICE OF THE INSURANCE
COMMISSIONER**



FINANCIAL EXAMINATION
of the Charitable Gift Annuity Business
of
Children's Health Care System
Seattle, Washington

DECEMBER 31, 2005

Order No. G07-20
Children's Health Care System
Exhibit A

SALUTATION

Seattle, Washington
March 8, 2007

The Honorable Mike Kreidler, Commissioner
Washington State Office of the Insurance Commissioner (OIC)
Insurance Building, Capitol Campus
302-14th Avenue SW
Olympia, WA 98505

Dear Commissioner Kreidler:

In accordance with your instructions and in compliance with the statutory requirements of Chapter 48.38 RCW, Charitable Gift Annuity (CGA) business, an examination was made of the corporate affairs and financial records of the CGA business of

Children's Health Care System

of

Seattle, Washington

hereinafter referred to as "CHCS" at the location of its office, 6901 Sand Point Way NE, Seattle, WA 98115.

This report of examination is respectfully submitted showing the condition of CHCS as of December 31, 2005.

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of the Charitable Gift Annuity business of Children's Health Care System of Seattle, Washington. This report shows the financial condition of the Charitable Gift Annuity business and related corporate matters of Children's Health Care System as of December 31, 2005.

A handwritten signature in black ink, appearing to read "Patrick H. McNaughton", written over a horizontal line.

Patrick H. McNaughton
Chief Examiner

3-8-2007

Date

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SCOPE OF THE EXAMINATION

This examination covers the period January 1, 2001 through December 31, 2005. The 2005 Annual Report reflected the balance sheet and statement of revenue and expenses of CHCS as of September 30, 2005. The OIC granted permission to CHCS to present its CGA Annual Report as of its fiscal year ended September 30, 2005. The examination of the 2005 Annual Report, therefore, covers the period ending September 30, 2005 for the balance sheet and statement of revenue and expenses sections, and the period ending December 31, 2005 for the general interrogatories and charitable gift annuities reserve fund. The audited financial statements are presented on a consolidated basis for CHCS and its affiliates. However, the scope of our examination focused only on the transactions and operations of the CGA business. CHCS' records, along with various aspects of its operating procedures and financial reports, were reviewed and tested during the course of this examination as necessary to substantiate CGA business reporting. The results of the examination are commented upon in the various sections of this report. In addition, CHCS' certified public accountant's (CPA's) reports were reviewed and utilized, where possible, to facilitate efficiency in the examination.

The examination was conducted in accordance with the statutory requirements contained in the Revised Code of Washington (RCW) and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook (FCEH). The examination was conducted at the Seattle office of CHCS by examiners from the state of Washington.

INSTRUCTIONS

The examiners reviewed CHCS' Annual Reports as part of the statutory examination. This review was performed to determine if the organization completed the Annual Reports in accordance with the Annual Report Instructions published by the OIC and to verify that the organization's accounts and records were prepared and maintained in accordance with Chapter 48.38 RCW.

INSTRUCTIONS

No exceptions were noted and no instructions are included in this examination report.

COMMENTS AND RECOMMENDATIONS

Documentation of Closed Annuity Contracts

CHCS did not always obtain a death certificate to support the transfer of the remaining residuum funds of closed annuity contracts.

It is recommended that CHCS obtain death certificates in addition to any other relevant, important data currently gathered by or furnished to CHCS to fully

document an annuitant's death. All documentation should be kept in the annuitant's file.

ORGANIZATION PROFILE

History: CHCS operates exclusively for charitable, scientific or educational purposes. It is organized to provide health care services to infants, children and adolescents, and to deliver those services through research, education, advocacy, and contributions to or for the benefit of tax-exempt organizations.

Territory and Plan of Operation: On September 10, 1998, the OIC granted CHCS a Certificate of Exemption to Issue Charitable Gift Annuities in the state of Washington. There were 104 in-force annuity contracts as of December 31, 2005. Total annuity contracts included all 36 contracts transferred from Children's Hospital and Regional Medical Center (CHRM) during 2005. CHCS and CHRM combined the two groups of annuities; therefore, there is only one certificate of exemption holder effective December 31, 2005, which is CHCS. CHCS is now responsible for the administration and payment of all CGA contracts issued originally by CHRM and CHCS.

Total Net Assets: CHCS' total net assets as of September 30, 2005 were \$404,799,000. This amount included an unrestricted net asset of \$319,375,000. The minimum unrestricted net asset requirement pursuant to RCW 48.38.010(6) was satisfied as of September 30, 2005.

Growth: The development of CHCS for the past five years is reflected in the following schedules. The financial statements of CHCS and its affiliates have been presented on a consolidated basis. The schedules below, however, show only the financial information related to CHCS, as of fiscal years ending September 30, in accordance with the OIC Annual Report Instructions.

Schedule 1 – Statement of Financial Position

(In thousands)						
Fiscal			Total	Total Net Assets Allocated Into:		
<u>Year</u>	<u>Assets</u>	<u>Liabilities</u>	<u>Net Assets</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>
2005	\$428,183	\$23,384	\$404,799	\$319,375	\$14,875	\$70,549
2004	370,011	11,570	358,441	279,696	13,667	65,078
2003	332,365	9,164	323,201	254,287	11,890	57,024
2002	311,287	22,074	289,213	217,237	10,297	61,679
2001	298,870	11,179	287,691	228,251	11,470	47,970

Schedule 2 – Statement of Activities and Changes in Net Assets

(In thousands)					
	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Revenues and gains (loss)	\$51,412	\$43,616	\$40,201	\$8,034	\$(29,901)
Expenses	5,054	8,376	6,213	6,512	11,480
Increase (decrease) in net assets	46,358	35,240	33,988	1,522	(41,381)
Net assets at beginning of year	358,441	323,201	289,213	287,691	329,072
Net assets at end of year	\$404,799	\$358,441	\$323,201	\$289,213	\$287,691
Number of gift annuity contracts at end of year	104	60	57	43	36

AFFILIATED COMPANIES

CHCS is the parent organization of several affiliated Washington not-for-profit corporate entities which include the following: CHRMC, Children's Hospital Foundation, Children's Hospital Guild Association, Children's Retail, Health Team Northwest, and Children's Physicians.

MANAGEMENT AND CONTROL

Management: Pursuant to CHCS' Bylaws, the Board of Trustees (BOT) consists of voting trustees and non-voting trustees. Responsibility for governing CHCS is vested in the voting trustees who are elected by CHCS at its annual meeting. The voting members of CHCS include all CHCS trustees and honorary trustees of CHRMC. The sole voting member of CHRMC is CHCS.

Board of Trustees: There are 28 trustees; of these, 25 are voting trustees and three are non-voting trustees. The trustees are:

Kathleen Randall, Chairman
Peggy Walton, Vice Chairman
Mary Ann Flynn, Recording Secretary
Linda Stull, Corresponding Secretary

Catherine Heron
Eugenia Higgins
Laura Jennings
Priscilla Joondeph

Rhoda Altom, Treasurer
Gloria Northcroft, Assistant Treasurer
Sue Albrecht
Prudence Baldwin
Sherry-Lee Benaroya
Jane Blair
Julia Calhoun
Nancy Daly
Margaret Habegger
Thomas Hansen, M.D.

James Ladd
Mona Locke
Cindy Masin
Linda Mattox
Richard Molteni, M.D.
Teresa Moore
Laurie Oki
Robert Roskin, M.D.
Janet Sinegal
Didina Wells

Officers: Pursuant to the Bylaws, the officers of CHCS include a chief executive officer (CEO), who holds the title of president and CEO. The CEO is selected and employed by the BOT. According to the organizational chart, CHCS' officers include, but are not limited to, the following: a president and CEO, a vice president general counsel, an executive vice president and chief operating officer (COO), and a vice president and chief financial officer (CFO).

Thomas Hansen, M.D., President and CEO
Jeff Sconyers, Vice President General Counsel
Pat Hagan, Executive Vice President COO
Kelly Wallace, Vice President CFO

Tax Status: CHCS is a Washington not-for-profit corporation and is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code.

Conflict of Interest: The BOT adopted and implemented a written conflict of interest policy that includes guidelines for the resolution of any existing or apparent conflict of interest. The Audit and Corporate Responsibility Committees have general responsibility for oversight of the conflict of interest disclosure process. There were no exceptions noted.

CORPORATE RECORDS

The BOT met twelve times in 2005 to discuss business which is pertinent to CHCS. Minutes of the meetings of trustees documented the approval of CHCS' transactions and events. No exceptions were noted.

STATEMENT OF ACTUARIAL OPINION

A consulting actuary with Milliman, Inc., reviewed the adequacy of the annuity reserves and issued a Statement of Actuarial Opinion (SAO) which stated that he is a member of the American Academy of Actuaries and meets its qualification standards. His SAO states that CHCS' annuity contract reserves computed under RCW 48.38.020(3)(a) and (b) of the Washington Insurance Code should be \$3,194,651. This amount, plus the 10% surplus required by RCW 48.38.020(3)(c), was reported as CGA liabilities in CHCS financial statements.

ANNUITY ASSETS CUSTODIAL FUNCTION

The separate reserve fund assets were held legally and physically segregated from the other assets of CHCS. Total annuity investments as of December 31, 2005 were \$4,423,176, and consisted of money market funds, U.S. government obligations, corporate stocks and bonds, and mutual funds. Investments were recorded at fair value.

SUBSEQUENT EVENTS

There were no material events which impacted CHCS' CGA business between the examination date and the last day of our field work.

ACCOUNTING RECORDS AND PROCEDURES

The records and source documentation supported the data and amounts presented in the annual reports and financial statements.

FINANCIAL STATEMENTS

The following financial information summarizes the financial statements of CHCS as of September 30, 2005:

Balance Sheet

	Balance Per Annual Report	Adj.	Examination Adjustments	Adjusted Balance
<u>ASSETS</u>				
Cash and cash equivalents	\$0		\$0	\$0
Receivables from affiliates, net	14,216,000			14,216,000
Investments	341,126,824			341,126,824
CGA assets*	4,423,176			4,423,176
Other assets	68,417,000			68,417,000
Total Assets	\$428,183,000		\$0	\$428,183,000
<u>LIABILITIES</u>				
Accounts payable	\$255,000		\$0	\$255,000
Payables to affiliates	12,527,000			12,527,000
CGA reserves*	3,514,116			3,514,116
Other liabilities	7,087,884			7,087,884
Total Liabilities	23,384,000			23,384,000
<u>NET ASSETS</u>				
Unrestricted	319,375,000			319,375,000
Temporarily restricted	14,875,000			14,875,000
Permanently restricted	70,549,000			70,549,000
Total Net Assets	404,799,000			404,799,000
Total Liabilities and Net Assets	\$428,183,000		\$0	\$428,183,000

*The distribution of the annuity assets and statutory reserves are based on the Statement of Actuarial Opinion as of December 31, 2005.

Statement of Financial Activity and Changes in Net Assets

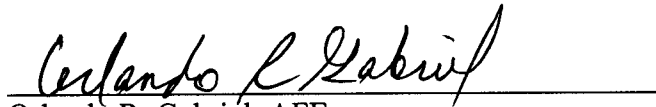
	Balance Per <u>Annual Report</u>	<u>Adj.</u>	<u>Examination Adjustments</u>	<u>Adjusted Balance</u>
Total revenues	\$51,412,000		\$0	\$51,412,000
Total expenses	<u>5,054,000</u>		<u>0</u>	<u>5,054,000</u>
Increase (decrease) in net assets	46,358,000		0	46,358,000
Net assets at beginning of year	358,441,000			358,441,000
Changes in net assets per examination	<u>0</u>		<u></u>	<u>0</u>
Net assets at end of year	<u>\$404,799,000</u>		<u>\$0</u>	<u>\$404,799,000</u>

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers and employees of CHCS during the course of this examination.

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner, from the Washington State Office of the Insurance Commissioner, participated in the examination and the preparation of this report.

Respectfully submitted,

A handwritten signature in cursive script, reading "Orlando R. Gabriel", is written over a horizontal line.


Orlando R. Gabriel, AFE
Examiner-in-Charge
State of Washington

AFFIDAVIT


STATE OF WASHINGTON }
 } ss
COUNTY OF KING }

Orlando R. Gabriel, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of his knowledge and belief.

He attests that the examination of CHCS' CGA business was performed in a manner consistent with the standards and procedures required or prescribed by the Washington State Office of the Insurance Commissioner and the National Association of Insurance Commissioners (NAIC).


Orlando R. Gabriel
Examiner-in-Charge
State of Washington

Subscribed and sworn to before me on this 8th day of March, 2007.


Notary Public in and for the
State of Washington,
Residing at Seattle.

